

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

In re:

MALKUS, INC.,

CASE NUMBER: 03-07711-GLP

Debtor.

_____ /

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This Case is before the Court upon Debtor's Plan of reorganization. After hearings held on June 24, 2004, July 6, 2004 and August 25, 2004 the Court makes the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. On July 30, 2003, Malkus, Inc. ("Debtor") filed a voluntary petition under Chapter 11 of the Bankruptcy Code.
2. Debtor's sole asset and business operation is the ownership and operation of a 113-unit Howard Johnson Express Motel in Deland, Florida (the "Motel"). The Motel is operated by one of its 50% shareholders, Charles Malkus ("Malkus"). Malkus' wife, Judith ("Judith") owns the other 50%. The Motel is an exterior corridor, approximately 30-year-old concrete block facility located outside the city limits of Deland, Florida.
3. At the time Debtor entered into its lending relationship with LaSalle National Bank ("LaSalle"), the Motel operated under a franchise agreement with Choice Hotels Franchising, Inc. as a Quality Inn. In April 2001, Debtor's franchise with Choice Hotels Franchising, Inc. was terminated.

4. After termination of the franchise agreement with Quality Inn, Debtor entered into a franchise agreement with Howard Johnson's International, Inc., the flag under which it continues to operate. In the Motel's most recent quality assurance audit, the Motel received a score of 373 out of a possible score of 500; a score below 370 constitutes a failing score. (LaSalle's Ex. 47)

5. On August 20, 1998, the Debtor executed in favor of Archon Financial, LP (the "Original Lender") a Mortgage Note in the amount of \$2,700,000.00 (the "Note"). The Note was secured by a first priority mortgage lien upon and security interest in all of the real and personal property comprising the Motel. As of the petition date, the outstanding principal balance due on the Note, exclusive of any interest, prepayment or yield maintenance amount, and fees and costs, was \$2,422,980.21. (LaSalle's Ex. 5) The Original Lender's interest in the Note and other loan documents was subsequently assigned to LaSalle.

6. The lending relationship between the Debtor and LaSalle, is a securitized, pooled financing arrangement, or a commercial mortgage backed securities transaction ("CMBS financing").

7. In December 2000, notwithstanding the prohibition against any junior financing contained in paragraph eight (8) of the Mortgage, Debtor executed a second mortgage in favor of First Community Bank as security for a personal debt of Malkus and Judith. (LaSalle's Ex. 53). The First Community Bank second mortgage was undertaken without the written consent of LaSalle. (LaSalle's Ex. 53)

8. On October 1, 2002 Debtor defaulted under the Note and other Loan Documents. Debtor also stopped making the required tax and insurance escrow payments, as well as the capital improvement and replacement reserve payments required under the terms of the Loan Documents.

9. On February 20, 2003, Lender started a foreclosure proceeding to foreclose its first priority mortgage lien and security interest in the Motel. (LaSalle's Ex. 48) In

order to prevent the grant of summary judgment, and appointment of a receiver in the foreclosure case, Debtor filed this Chapter 11 case on July 30, 2003, the day of the summary judgment hearing. (LaSalle Ex's 48, 50 and 51)

10. On September 5, 2003, Debtor and LaSalle entered into a Stipulation Authorizing Debtor's Use of Cash Collateral and Providing Adequate Protection to Lender (the "Stipulation"). (LaSalle's Ex. 11) The Stipulation required Debtor to pay LaSalle at the end of every month the net cash generated from the operation of the Motel, less the actual approved expenditures and the operating reserves; and to escrow \$3,941.00 monthly in order to pay the post-petition real estate taxes. (LaSalle's Ex. 11) On September 25, 2003, the Court approved the Stipulation.

11. Notwithstanding the Stipulation, Debtor failed to operate within the agreed budget, failed to escrow the required real estate tax amounts, and failed to deliver to LaSalle the monthly net income for months during which a positive net income was derived.

12. On November 4, 2003, the Court entered an order that required Debtor to comply with the budget, to escrow \$3,941.00 per month for taxes, and to otherwise comply with the Stipulation. (LaSalle's Ex. 12) When Debtor still failed to comply with the Stipulation, the Court entered an Order lifting the automatic stay to permit LaSalle to proceed with the foreclosure case through the entry of final judgment, with no sale to occur without further Court order. (LaSalle's Ex. 13).

13. In the Fall of 2003, Malkus "loaned" a variety of funds to the Debtor in order to keep the Motel operating, and also had the Debtor repay such "loans" without any authorization or approval by the Court.

14. Debtor's Plan is comprised of twelve (12) classifications of claimants. Class One (1) addresses Administrative Claims, Class Two (2) addresses Priority Claims, Classes Three (3) through Ten (10) address the treatment of secured claims, Class Eleven addresses the treatment of unsecured claims and Class Twelve (12) addresses Equity Interests.

15. The Plan was rejected by Class 4 (LaSalle) and by Class 11 (unsecureds).

16. Class Four (4) provides the treatment for the allowed secured claim of LaSalle, and provides for a claim in the amount of \$1.95 million at 6.5% interest, amortized over twenty (20) years with a balloon payment to be made in ten years.

17. Class Eleven (11) provides the treatment for unsecured claims. Class Eleven (11) of the Plan provides as follows:

The Allowed Claims of Unsecured Creditors receive twelve quarterly distributions of \$5,000.00 commencing 90 days after Effective Date, which will be distributed pro-rata to the holders of Allowed General Unsecured Claims. All Unsecured Claims of Insiders shall be subordinated to the payment of other General Unsecured Claims.

17. In February, 2004 Debtor made an adequate protection payment to LaSalle in the amount of \$20,000. Since the pendency of the case no other adequate protection payments to LaSalle have been made.

CONCLUSIONS OF LAW

In order for the Court to confirm Debtor's plan it must satisfy the requirements of 11 U.S.C. § 1129. If all the requirements of § 1129(a), with the exception of paragraph eight have been met, a proposed plan can still be confirmed under the provisions of § 1129(b). The Court finds that the plan does not meet the requirements of Sections 1129(a)(2), (a)(3) and (a)(11).

A. The Plan Fails to Comply With § 1129(a)(2)

Section 1129(a)(2) of the Bankruptcy Code provides that the court shall confirm a plan only if "[t]he proponent of the Plan complies with the applicable provisions of this title." While § 1129(a)(2) is typically thought to address issues of plan solicitation and disclosure, debtor conduct which violates other Bankruptcy Code provisions may also warrant a finding that § 1129(a)(2) has not been met. *See, e.g., In re Midwestern Cos.*, 55 B.R. 856, 863 (Bankr. W.D. Mo. 1985); *Cothran v. United States*, 45 B.R. 836, 875 (Bankr. S.D. Ga. 1984).

“[I]f the proposed plan of reorganization is to serve the interests of the creditors in this case, much depends upon the character and good conduct of those who will remain on the payroll as insiders and who will otherwise have a voice in determining how operations will be conducted and how revenues therefrom will be distributed.” In re Midwestern Cos., 55 B.R. at 863. In the instant case, LaSalle asserts that Debtor and its management have failed to perform and carry out the fiduciary duties otherwise incumbent upon a debtor-in-possession, and have engaged in self dealing over the course of the case. Additionally, LaSalle argues Debtor has failed to investigate or pursue any claims against its principals and related entities; failed to file tax returns as ordered by the Court; failed to report all of its income; paid a salary to the Debtor’s principal in months when the Debtor lost money; operated a lounge in violation of state law; breached cash collateral orders and stipulations; failed to adhere to Court-approved budgets; and unilaterally reduced the amount of Court-ordered tax escrow payments.

The Court finds that Debtor’s actions and behavior over the course of this case have been in violation of the Bankruptcy Code. Debtor continually failed to abide by the orders of this Court and for a good majority of the case the Debtor’s president attempted to operate the Motel as though neither he nor the Debtor were subject to the jurisdiction of the Court. Although the Court continually warned Debtor’s president, over the course of many hearings, that the requirements of the bankruptcy code were not being complied with, the Debtor in essence snubbed its nose at the Court and continued to violate court orders and operate outside the parameters of the Code. Therefore, the Court finds that the requirements of § 1129(a)(2) have not been met.

B. The Plan Fails to Comply with § 1129(a)(3)

Although the Bankruptcy Code does not specifically define good faith, good faith

requires that there be a “reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Code.” McCormick v. Blanc Leasing Corp., 49 F.3d 1524, 1526 (11th Cir. 1995).

Pursuant to § 1129(a)(3) a plan must be proposed in good faith and not by any means forbidden by law. LaSalles asserts that Debtor’s plan was not filed in good faith and that Debtor and its principal (Malkus) have engaged in a variety of actions which are tainted with unfairness, conflicts of interest, the appropriating of estate benefits for himself, and self-dealing. Specific examples of Debtor’s objectionable conduct include:

(a) Malkus’ failure, in his capacity as the Debtor’s president, to investigate potential preference claims against either himself or affiliates.

(b) Debtor’s shareholders (Malkus and Judith) retaining all equity interests with no new investment, while unsecured creditors receive virtually nothing.

(c) Malkus, in his capacity as Debtor’s president, paying himself a salary while LaSalle went unpaid.

Based upon the above, as well as the reasoning set forth in the previous section, the Court does not find that there is a reasonable likelihood that the plan will achieve a consistent result with the Bankruptcy Code’s objectives and purposes. Thus, Debtor’s plan fails to comply with § 1129(a)(3).

C. The Plan Fails to Comply With § 1129(A)(11)

Pursuant to § 1129(a)(11) a plan of reorganization must be feasible. “Although success does not have to be guaranteed, the Court is obligated to scrutinize a plan carefully to determine whether it offers a reasonable prospect of success and is workable.” In re Yates Development, 258 B.R. 36, 44 (Bankr. M.D. Fla. 2000).

§ 1129(a)(11) of the Bankruptcy Code provides, in pertinent part, that the Court shall confirm a plan only if:

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

“Visionary schemes are not sufficient to make a plan feasible.” In re Sovereign Oil Co., 128 B.R. 585, 587 (Bankr. M.D. Fla. 1991) A debtor’s past performance is one of the most important measures of whether a debtor’s plan will succeed.

LaSalle argues that Debtor’s expenses, during the post-petition period of operations, exceeded Debtor’s own budget in virtually every month (once adjusted for budgeted items – such as payments to the Lender (that were not made)- are figured in). In addition, LaSalle asserts that Debtor even lost money in two of the months that were projected by the Debtor to be successful, revenue producing months.

Although Debtor’s revenues have risen during the months of July, 2004, August, 2004 and September, 2004, Debtor’s dismal track record spanning over the pendency of Debtor’s case has clearly shown that the projections relied upon in the Plan are unreasonable and unachievable. The Court cannot simply overlook the motel’s historical poor operating results because of a few months in which the Debtor was either able to meet or surpass the motel’s projected revenues. Based upon the above the Court finds Debtor’s plan is not feasible.

CONCLUSION

The Court finds the Debtor has failed to carry its burden, as the proponent of the Plan. Debtor has failed to prove the requirements of Sections 1129(a)(2),(a)(3) and (a)(11). Therefore, the plan cannot be confirmed and the Court will dismiss the case. The Court will enter a separate order consistent with these Findings of Fact and Conclusions of Law.

Ordered in Jacksonville, Florida this 15 day of November, 2004.

/s/ George L. Proctor
George L. Proctor
United States Bankruptcy Judge

Copies to:

Richard R. Thames, Esq.
Malkus, Inc.
Andrew M. Brumby, Esq.
United States Trustee